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## MEMORANDUM

**TO:** Committee on Legal Services

**FROM:** Esther van Mourik, Office of Legislative Legal Services

**DATE:** January 25, 2018

**SUBJECT:** Rules of the Taxpayer Service Division, Department of Revenue, concerning notice and reporting requirements for non-collecting retailers, 1 CCR 201-1 (LLS Docket No. 170430; SOS Tracking No. 2017-00279).<sup>1</sup>

### Summary of Problem Identified and Recommendation

Section 39-21-112 (3.5)(c) and (3.5)(d), C.R.S., contains three reporting requirements for a retailer that does not collect Colorado sales tax, and each requirement assesses a penalty payable by the retailer for failure to comply. The statute for each requirement allows the penalty to be waived if "the retailer shows reasonable cause for such failure." But Rule 39-21-112 (3.5) of the Department of Revenue (Department) provides for circumstances when the penalty will not be assessed (de minimis non-collecting retailer in subsection (3) and de minimis purchaser in subsection (5)(b)) in sections (4)(g)(ii)(C), (5)(c)(ii)(D), (5)(c)(ii)(E), (6)(f)(ii)(D), and (6)(f)(ii)(E) of the rule, in contravention to statute. **Because sections (3), (4)(g)(ii)(C), (5)(b), (5)(c)(ii)(D), (5)(c)(ii)(E), (6)(f)(ii)(D), and (6)(f)(ii)(E), of Rule 39-21-112 (3.5) conflict with the statute, we recommend that these sections of Rule 39-21-112 (3.5) of the Department of Revenue not be extended.**

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<sup>1</sup> Under § 24-4-103, C.R.S., the Office of Legislative Legal Services reviews rules to determine whether they are within the promulgating agency's rule-making authority. Under § 24-4-103 (8)(c)(I), C.R.S., the rules discussed in this memorandum will expire on May 15, 2018, unless the General Assembly acts by bill to postpone such expiration.

## Rulemaking Authority

The Department has authority under section 39-21-112, C.R.S., to adopt rules governing the tax statutes. Section 31-21-112 (1), C.R.S., states:

**39-21-112. Duties and powers of the executive director.** (1) It is the duty of the executive director to administer the provisions of this article, and he or she has the power to adopt, amend, or rescind such rules not inconsistent with the provisions of this article, articles 22 to 29 of this title, and article 3 of title 42, C.R.S., ...

## Analysis

**The statute, without exception, includes three reporting requirements for a retailer that does not collect Colorado sales tax and assesses penalties for failure to comply.**

A retailer that does not collect Colorado sales tax is required to make certain notifications when a Colorado purchaser makes a purchase:

**39-21-112. Duties and powers of executive director.** (3.5) (c) (I) **Each retailer that does not collect Colorado sales tax shall notify Colorado purchasers** that sales or use tax is due on certain purchases made from the retailer and that the state of Colorado requires the purchaser to file a sales or use tax return.

(II) Failure to provide the notice required in subparagraph (I) of this paragraph (c) **shall subject the retailer to a penalty of five dollars for each such failure, unless the retailer shows reasonable cause for such failure.**

(d) (I) (A) **Each retailer that does not collect Colorado sales tax shall send notification to all Colorado purchasers** by January 31 of each year showing such information as the Colorado department of revenue shall require by rule and the total amount paid by the purchaser for Colorado purchases made from the retailer in the previous calendar year. Such notification shall include, if available, the dates of purchases, the amounts of each purchase, and the category of the purchase, including, if known by the retailer, whether the purchase is exempt or not exempt from taxation. The notification shall state that the state of Colorado requires a sales or use tax return to be filed and sales or use tax paid on certain Colorado purchases made by the purchaser from the retailer.

(II) (A) **Each retailer that does not collect Colorado sales tax shall file an annual statement for each purchaser** to the department of revenue on such forms as are provided or approved by the department showing the total amount paid for Colorado purchases of such purchasers during the

preceding calendar year or any portion thereof, and such annual statement shall be filed on or before March 1 of each year.

(III) (A) Failure to send the notification required in subparagraph (I) of this paragraph (d) **shall subject the retailer to a penalty of ten dollars for each such failure, unless the retailer shows reasonable cause for such failure.**

(B) Failure to file the annual statement required in sub-subparagraph (A) of subparagraph (II) of this paragraph (d) **shall subject the retailer to a penalty of ten dollars for each purchaser that should have been included in such annual statement, unless the retailer shows reasonable cause for such failure.**  
(Emphases added)

The rule, by contrast, specifies that the penalty is not imposed if the retailer is a de minimis non-collecting retailer or if the purchaser is a de minimis Colorado purchaser, as defined in the rule:

**RULE 39-21-112 (3.5). Notice And Reporting Requirements For Non-Collecting Retailers.**

(3) **De Minimis Non-Collecting Retailers.** For purposes of this rule, a retailer that makes less than \$100,000 in Total Gross Sales in Colorado in the prior calendar year and reasonably expects Total Gross Sales in Colorado in the current calendar year will be less than \$100,000 is a retailer whose sales in Colorado are de minimis. In the calculation of such Total Gross Sales, a retailer must include all Total Gross Sales made by all corporations in a controlled group of corporations pursuant to 26 U.S.C. 1563 of which group such retailer is a member.

(4) **Transactional Notices.** A Non-Collecting Retailer shall provide a Transactional Notice with every Colorado Reportable Purchase not exempt from Colorado sales and use tax.

(g) *Penalties.*

(ii) If the Non-Collecting Retailer meets the criteria below, the penalty assessed against the Non-Collecting Retailer in a single year, pursuant to this section, shall not exceed the specified amounts:

**(C) No penalty shall be collected with respect to sales that are de minimis under paragraph (3) of this rule.**

**(5) Annual Purchase Summary.**

(b) *De Minimis Colorado Purchaser.*

(i) For the purpose of this rule, a Colorado Purchaser whose total Colorado Reportable Purchases for the prior calendar year are less than \$500 is a Colorado Purchaser whose purchases are de minimis.

(ii) If the tangible personal property or other charges assessed against the Colorado Purchaser are not subject to Colorado tax, a Non-Collecting Retailer may choose to exclude such purchases from the calculation of the Colorado

Purchaser's total purchases for the prior calendar year; however, the Non-Collecting Retailer is not obligated to do so.

(iii) Any Non-Collecting Retailer shall make commercially reasonable business efforts, based on the business's existing billing, customer-tracking, or other systems, to identify multiple Colorado Reportable Purchases made by a single Colorado Purchaser from the Non-Collecting Retailer.

*(c) Penalties.*

(ii) If the Non-Collecting Retailer meets the criteria below, the penalty assessed against the Non-Collecting Retailer, pursuant to this section, shall not exceed the specified amounts:

**(D) No penalty shall be collected with respect to sales that are de minimis under paragraph (3) of this rule.**

**(E) No penalty shall be collected for any Non-Collecting Retailer's failure to send an Annual Purchase Summary for purchases that are de minimis under paragraph (5)(b) of this rule.**

**(6) Annual Customer Information Report.**

*(f) Penalties.*

(ii) If the Non-Collecting Retailer meets the criteria below, the penalty assessed against the Non-Collecting Retailer, pursuant to this section, shall not exceed the specified amounts:

**(D) No penalty shall be collected with respect to sales that are de minimis under paragraph (3) of this rule.**

**(E) If all of a Non-Collecting Retailer's sales to Colorado Purchasers are de minimis under paragraph (5)(b) of this rule, no penalty shall be collected. (Emphases added)**

However, the statute only provides a waiver of the penalty if the retailer shows reasonable cause. From a legal perspective, showing cause requires the retailer, on a case-by-case basis, to explain to the department why the penalty should not be assessed in that particular case. By including automatic penalty waivers for de minimis non-collecting retailers and de minimis Colorado purchasers in rule, the Department is circumventing the requirement that the retailer show cause for the failure to act. Even the Department's broad rulemaking authority under section 39-21-112 (1), C.R.S., specifies that the rules may not be "inconsistent with the provisions of" article 21 in which the reporting requirements are found.

Section 39-21-112 (3.5)(c) and (3.5)(d), C.R.S., clearly requires the assessment of the penalty and specifies that the penalty may be waived only when the retailer shows cause for failing to comply. Automatic penalty waivers, unrelated to "reasonable cause", are inconsistent with statute. If the Department has found in its administration of section 39-21-112 (3.5)(c) and (3.5)(d), C.R.S., that the penalties should not be assessed in situations when the purchases are de minimis or when the purchaser is de

minimis, then the Department could request legislation to add such penalty waivers in statute. Furthermore, while the Department may argue that the rule sets forth what "reasonable cause" might be, the rule does not describe it as such, and the statute specifically requires the **retailer** to show reasonable cause, not the Department.

Finally, sections (3), (4)(g)(ii)(C), (5)(b), (5)(c)(ii)(D), (5)(c)(ii)(E), (6)(f)(ii)(D), and (6)(f)(ii)(E), of Rule 39-21-112 (3.5) conflict with the statute in its application. The statute requires, in summary, that:

- "**Each retailer** that does not collect Colorado sales tax shall notify **Colorado purchasers** that sales or use tax is due" (presumably this means all Colorado purchasers);
- "**Each retailer** that does not collect Colorado sales tax shall send notification to **all Colorado purchasers** . . . the total amount paid by the purchaser for Colorado purchases made from the retailer";
- "**Each retailer** that does not collect Colorado sales tax shall file an annual statement for **each purchaser** . . .".

The statutory reporting requirements do not make a distinction between de minimis retailers or de minimis purchasers, and instead require the notifications by every retailer for every purchaser. While the rule does not specifically exempt certain non-collecting retailers from complying with the three reporting requirements, it does in its application. Without the imposition of penalties, non-collecting retailers that meet the de minimis non-collecting retailer definition will likely not provide the required notifications or file the required annual statements. Furthermore, without the imposition of penalties, non-collecting retailers will likely not provide the required notifications or file the required annual statements regarding de-minimis purchasers either.

## **Recommendation(s)**

We therefore recommend that sections (3), (4)(g)(ii)(C), (5)(b), (5)(c)(ii)(D), (5)(c)(ii)(E), (6)(f)(ii)(D), and (6)(f)(ii)(E), of Rule 39-21-112 (3.5) of the Department concerning de minimis retailers and de minimis purchasers not be extended because they conflict with statute.